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Fulfillment of VAT tax agent responsibility

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Based on the results of case session No. A72-5929/2010 held on 3 April 2012, the Presidium of the RF Supreme Arbitration Court (the RF SAC) issued Resolution No 15483/11 in relation to tax agents paying value-added tax (hereinafter – "VAT") from their own funds when purchasing work and/or services subject to Russian VAT from a foreign company that is not a Russian taxpayer.

General legislative requirements

In accordance with clauses 1 and 2 of Article 161 and clause 3 of Article 166 of the Tax Code of the Russian Federation (hereinafter – the "RF Tax Code"), when goods/work/services which are deemed to be supplied on the Russian Federation territory are sold by foreign entities that are not registered with the Russian tax authorities for tax purposes, the VAT tax base shall be determined as the total income from the sale of such goods/work/services inclusive of VAT by the tax agent, registered with the Russian tax authorities, purchasing such goods/work/services. The tax agent shall assess the respective amount of VAT, withhold it from the foreign entity, and pay it to the tax authorities.

In accordance with clause 4 of Article 174 of the RF Tax Code, for the situation under review, VAT is paid by the tax agent at the same time as the payment (or transfer) of cash is made to the foreign entity.

In accordance with clause 3 of Article 171 of the RF Tax Code, the above VAT paid by the tax agent may be claimed for recovery by the latter if the conditions established by the RF Tax Code for such a recovery are met.

Area of dispute

A taxpaying Russian company (the Company) and a foreign company which is not a Russian taxpayer (the Foreign company) made an agreement through which the Foreign company provided work and services to the Company that were subject to VAT in the Russian Federation, in accordance with the place of supply rules established by the RF Tax Code. The value of the agreement was fixed and did not include Russian VAT, and other additional payments were not provided for by the agreement.

When paying the Foreign company for the work and services it provided, the Company did not fulfill its tax agent obligation to pay VAT to the Russian tax authorities on the remuneration for the Foreign company as, in the Company's opinion, it was unable to withhold VAT from the remuneration for the Foreign company in accordance with the provisions of the agreement, and it was not liable to pay VAT to the tax authorities from its own funds.

According to the tax authorities, in violating the RF Tax Code, the Company failed to act as a tax agent and pay VAT using its own funds when paying for the work and services provided by the Foreign company.

The position of the courts

The first three courts to review the case supported the tax authorities' claim that the Company had violated the provisions of the RF Tax Code and had failed, without adequate justification, to perform its functions as a tax agent. According to the courts, the fulfillment of VAT payment obligations by a tax agent cannot be provided for by conditions in the agreement between the Company and the Foreign company. Therefore, in the opinion of the courts, the Company was guilty of committing a tax offence, and a tax penalty for failing to act as a tax agent and appropriate late payment interest were legitimately imposed on the Company.

At the same time, the courts considered the tax authorities' demand of the Company to pay the disputed VAT amount using its own funds to be illegal, as the agreement between the Company and the Foreign company was no longer valid when the tax review was carried out. Therefore, when the contended decision was made by the tax authorities, the Company was unable to withhold the disputed tax amount from the Foreign company.

According to the ruling of the RF SAC on the case in question, a tax agent's incompliance with the procedure for withholding VAT from the income of a foreign counterparty through payment for the provision of services liable to VAT in the Russian Federation does not exempt the tax agent from its responsibility to pay VAT to the Russian tax authorities from its own funds.

According to the RF SAC, the interpretation of tax legislation made by the subordinate courts absolved the tax agent of its duty as established by the law and did not guarantee the payment of VAT to the tax authorities when goods/work/services are sold by a foreign entity in the Russian Federation, as in the given case.

However, the RF SAC also declared that the tax agent's obligation to pay VAT from its own funds corresponded with its right to recover VAT according to the procedure established by the RF Tax Code. Based on the above, the RF SAC decided to annul the decisions of the subordinate courts and obliged the Company to pay the disputed VAT to the Russian tax authorities from its own funds. The RF SAC upheld the decisions of the subordinate courts in terms of the Company being liable for a fine and in terms of the late payment interest it was charged.

Our conclusions

Current court practice has been ambiguous in relation to the payment of VAT from the funds of tax agents purchasing goods/work/services subject to VAT in the Russian Federation from foreign counterparties not registered with Russian tax authorities as taxpayers.

Some courts have pointed out the illegitimacy of charging tax agents additional VAT as the purview of the RF Tax Code does not include the obligation of a tax agent to pay tax that has not been withheld from the income of foreign counterparties, from its own funds.

Considering the position of the RF SAC on the matter in question, we believe that failure to pay VAT by tax agents from their own funds (if it is not possible to withhold tax from the remuneration given to a foreign seller of goods, work, or services subject to Russian VAT) in the case being studied may lead to disputes with the tax authorities, whose position will probably be supported by arbitration courts.

In light of the above, and in order to avoid disputes with the tax authorities, we believe that companies should analyse their respective agreements with foreign counterparties in order to define the place of supply of goods/work/services/property rights being purchased and, if necessary, to include provisions in such agreements on the pricing of the goods/work/services/property rights being purchased in order that the companies involved might avoid adverse tax consequences.

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